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THE INVESTMENT SECURITY BUSINESS

By ERASTUS W. BULKLEY

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The Investment Security Business

By
ERASTUS W. BULKLEY
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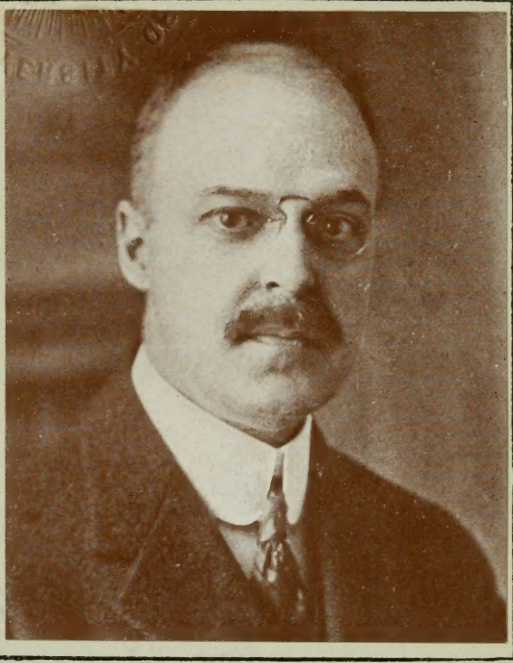

ERASTUS W. BULKLEY

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Erastus W. Bulkley received his early training in the Public Schools of Brooklyn. He was graduated from New York University in 1891. Five years later he received a degree from the New York College of Pharmacy.

His first business experience was in the drug and chemical lines. This was followed by a short period of service with the Pennsylvania Railroad Company. In 1898, he entered the service of Spencer Trask & Company, Investment Bankers, as assistant manager of their Albany, New York, office. Six years later he was appointed Sales Manager of the New York City office. In 1906, he was admitted as a partner in that firm, and is at present an active member.

Mr. Bulkley has long been an advocate of commercial education particularly for business men in the field of investment, banking and finance. He established the educational courses now in use by Spencer Trask & Company for salesmen and office employes. He is recognized among investment bankers as a close student of finance especially of the methods of distributing of securities to individual investors.

Mr. Bulkley was Governor and Chairman of the Foreign Relations Committee of the Investment Bankers' Association of America in 1912-1915 and is now a member of that Association's Educational Committee. He is also a member of the Advisory Board of New York University School of Commerce; a member of the American Economic Association and of the American Academy of Political and Social Science.

NOTE:—This Lecture, which is based upon the author's ripe experience in his special field, should be read in the light of the Modern Business Text, and should be studied as an authoritative message from the field of business activity.

The Investment Security Business

By

Erastus W. Bulkley

Investment literature, of which there is a growing flood, is for the most part written from the standpoint of the consumer, the investor. It is intended as a guide for the buyers of securities, and as such is concerned chiefly with the analysis of the various types of securities which the investment field offers. Little thought is given to the means by which they are distributed. It may, therefore, be of interest to consider more in detail, and from a practical standpoint, the scope of what may be broadly described as the investment security business. The business houses which occupy the field are called "bond houses", "bond dealers" or "investment bankers." The particular terms used are immaterial, as they have practically the same meaning.

General Characteristics

The essential functions which are common to such concerns are the buying and selling of evidences of corporate, municipal or individual debt, together with the financing necessary to handle them. The broad

underlying principles of the business are the same as in many others which involve successful merchandising as their main function. In the dry goods business, for instance, we find houses of all grades and conditions from the wholesale jobbing concerns to the extensive and highly organized distributing establishments which are both wholesalers and retailers, and so on down to the little store and even to the man who peddles neckties or handkerchiefs on the street. In the bond business, we find practically the same gradations, from the great underwriting concerns which are essentially wholesalers down thru the large distributing houses, to the small dealers and to the still smaller dealers or brokers who, like pedlers, practically have no offices, but who occasionally own a few bonds. No sharp lines can be drawn to show where the business of one class absolutely ends and the other begins, for the business of one merges almost imperceptibly into that of the others.

In every successful trading organization of whatever nature, whether simple or complex, we find three great underlying sets of forces in operation, namely, one set leading outward from the base of supply, embodied in the buying department; another set moving toward it from the base of demand, embodied in the selling department; and a third, which meets these with the power to do the temporary financing made necessary by the work of the first two, and termed the financial department. Ideal conditions would exist in the bond business or in any other trading business in which these three departments or primary sets

of forces were about evenly balanced from the standpoint of efficiency.

Ideal conditions rarely exist in practice. Some bond houses have active buying departments, but lack the means necessary to finance their proposed purchases; or again, when they have the means of financing them, they may be deficient in trained selling departments to dispose of the securities. A bond house is, of course, not a permanent investor, but only buys with the idea of selling again at a profit. On the other hand, some houses are known as being good sellers, but are constantly handicapped by inefficient buying departments.

In varying degrees of development these departments are found in all bond houses. The little bond dealer who carries his office in his hat is buying department, selling department and financial department combined. Some of the great distributing houses, on the other hand, have complex organizations which employ a large number of men scattered practically over all the country, and with subdivisions of the three departments in many of the more important financial centers.

It should be remembered that the underlying factors in the bond business are absolutely the same as in any other trading business. As this is the case, the broad and non-technical qualifications necessary for the success of those engaging in any part of the business are practically the same as for those engaging in similar positions in other trading organizations. Young men in other lines of business often

think that gold is to be picked up in Wall Street, metaphorically speaking, and that if they can only become affiliated with some of the better-known investment houses, they will be well along on the great highway to success. But positions with investment houses are not located "on the sunny side of Easy Street", nor do they offer prospects of success to those who have failed in similar positions elsewhere.

The Buying Department

The various sources of supply for the wares of bond houses are corporations, including railroads, public service, water power, irrigation, manufacturing, building and many others; governments, including our own federal and foreign governments, states, counties and municipalities; and individuals, who borrow more particularly on the security of real estate.

The buying department should be organized so as to be in constant touch with the various sources of supply of the classes of securities handled by the house. It should investigate all attractive offerings, and, with the approval of the financial and selling departments, purchase such as are desired and which have successfully met its tests of excellence. In short, it should attend to all matters necessary to place the goods in proper condition upon the counters of the house ready for the sales department. The work of the buying department is exceedingly important, for a bond well bought is about two-thirds sold.

The processes of negotiation for the sale of securi-

ties to the bond dealers differ with the various issues, the two principal methods being at public sale or at private sale. In this country, the usual method employed by the federal government, states, counties, cities, towns and districts is by public sale. At such sales a minimum price is frequently fixed, and the bonds are sold to the highest bidder. Individual investors occasionally compete with the bond dealer. As a rule, these individuals are not in touch with the market and oftentimes pay a higher price for bonds than if they had left the market to the bond dealer, and purchased later from him. Again, it sometimes happens that bonds have been illegally issued. The reliable bond dealer always has a legal opinion on the issue before purchasing. The individual investor must get this legal opinion at considerable cost or take a chance. Foreign governments, on the other hand, in floating loans more frequently place their securities with the large banking houses for distribution.

Corporations usually sell their issues at private sale, frequently offering them first to their stockholders. Very often certain corporations deal almost entirely with the same bankers in financing all of their requirements, expecting these bankers, under proper conditions and with certain modifications, to provide them with all funds necessary for the legitimate growth of their business.

Whether it buys an entire issue at private sale or bids on a large block of securities offered at public sale, the buying department of one house often joins with the buying departments of other houses in forming a syndicate or possibly simply an arrangement to buy on joint account. When you see that this or that great banking organization has bought $50,000,000 or $100,000,000 of bonds, it is not to be understood that it has necessarily purchased them all for its own account. The chances are that its direct interest in the business is relatively small and that associated with it in a syndicate are a number of other firms, institutions, or even large investors, each responsible for varying amounts of from $10,000, $25,000, $50,000, $100,000, $200,000 to $500,000 and so on. No banking house, however important or powerful, usually cares to assume the entire risk or tie up a large proportion of its capital in one security. When syndicates are formed the managers charge a commission for their services, which depends upon the amount of work, risk, and probable profit involved, and ranges from one-quarter of one per cent to occasionally two and one-half per cent, or even more, upon the original purchase price of the securities. Thus the formation of syndicates is frequently in itself a profitable business for the managers, altho, contrary to the general belief of the public, syndicates do not always prove profitable ventures for the participants.

It must be evident that in this department of investment security organizations great skill and experience are required. The work is one of the largest responsibility, and naturally offers high rewards to those who are intrusted with it. Only those who have a thoro understanding of the business in all its ins and outs are qualified for such responsible work.

The Financial Department

In addition to using their own capital, bond houses are at times large borrowers of money. It is the duty of the financial department to provide the funds needed to handle the bond issue from the time that it is presented to the house until it is sold and final payment received therefor. The financial department thus occupies a position midway between the buying department and the selling department, handling and financing the securities taken in by the buying department until their final disposition by the selling department. The buying department must frequently consult the financial department in order to avoid making a purchase of securities which, tho intrinsically sound and perhaps an excellent permanent investment, are not at the time readily available as collateral in the loans of the house.

There are times when bond houses, like other merchants, must be particularly careful not to overstock, and likewise, too, there are times when it is profitable to stock up heavily and thus to carry a large "inventory."

The Selling Department—Investor Classes

With the goods on the counter, as it were, let us take up the distribution of them to investors, which is the general work of the selling department. Who are the buyers of securities in this country? They may be roughly classed into two divisions—institutions and individuals. In an indirect way corporations buy for groups of individuals, while individuals may and often do act as agents for other individuals.

Institutions include (1) insurance companies, life, fire, marine, casualty, etc., (2) Banking institutions, such as savings, national, and state banks and trust companies, (3) Endowed educational institutions such as colleges and professional schools, (4) Governments and municipal corporations, which frequently purchase their own bonds or occasionally other bonds, for certain funds, and (5) Miscellaneous corporations, associations, railroads, public service companies and others, which also buy at times both their own bonds and other securities.

The individual investors may be roughly divided into the large buyers and the small buyers, or the great capitalists and the little capitalists, the people of large wealth and the thrifty people of comparatively small means.

The insurance companies are in the aggregate perhaps the largest institutional owners of securities, their holdings being made up principally of government, railroad and municipal bonds, with some public utility issues. The savings banks are a factor in the

investment market second only to the insurance companies. Broadly speaking, the securities which they purchase are usually high grade, altho the laws of the various states governing the investment of the funds of savings banks differ greatly, so that securities eligible for the investment of such funds in one state may be ineligible in another. National banks, as well as state banks and trust companies, absorb in the aggregate large amounts of bonds of all general classes.

The territorial distribution of the buyers of securities is also of interest. Most of the large insurance companies and the great savings banks and other fiduciary and financial institutions are located in the eastern part of the United States, so that the largest bond buying sections of the country are the New England and Middle Atlantic states. The Central and Western states, however, afford a considerable and most rapidly growing bond market which is capable of much enlargement. There is, however, practically no portion of the country in which bonds of some kind cannot at least occasionally be sold, but the investment houses naturally have to confine their main efforts to those sections in which there is the great concentration of surplus or accumulated capital, that is, the older and more developed portions of the country.

Selling Methods

After indicating roughly the sources of demand for bonds, let us consider the methods employed by the dealers to reach the same. The two main divisions

of these methods are (1) Written salesmanship, conducted thru the medium of newspaper and magazine advertising, circulars, circular letters and personal letters, and (2) Oral salesmanship, or the work conducted by direct conference with the investor, either in or out of the dealers' offices. Salesmen are therefore sometimes designated as (1) Office salesmen and (2) Outside or traveling salesmen. Yet there are no sharp lines of division between the two classes since outside salesmen must be competent to perform certain office duties, especially letter writing.

In the past fifteen years there has been a great development of advertising by the legitimate investment houses. Prior to that time, modern methods of advertising were seldom employed by any of them, largely because thru a misunderstanding of the principles of advertising, its methods were not regarded as sufficiently dignified for the investment banking business. With the growth in volume there has been a great improvement in the literature issued by the bond houses. Much of it is educational in its nature, and is designed to point out to the investor with surplus funds both the safe as well as the unsafe fields which may be competing for his attention. There has also been an improvement in the correspondence systems employed by many of the houses, both in the circular and in the personal letters issued.

In the larger and more highly developed bond houses, the outside salesmen are frequently divided into those who sell exclusively to institutions and those who sell to individuals. This is the case, how-

ever, only in the more populous districts. The majority of salesmen are expected to be able to sell to both institutions and individuals. Then again, some salesmen cover only the populous districts in or near the larger cities, while others travel thru the country districts and even into their remote corners. The various forces of the sales department must be welded into one homogeneous whole under the direction and the guidance of the sales manager, and thus the department itself is made into an efficient composite salesman. The larger bond houses, in addition to their main offices in New York City, or elsewhere, have branch offices or correspondents in different parts of the country, and thus keep in close and even intimate touch with investment conditions in practically all sections of the country.

Qualifications of Salesmen

The bond salesman of today is largely a product of the last twenty years. While there are many excellent and exceedingly high grade bond salesmen, it is doubtful if the selling ability of bond salesmen, as a class, averages so high as that of salesmen in manufacturing and mercantile lines. But conditions are rapidly changing, higher standards are being daily set, and the man who does not improve himself and keep pace with the new requirements must soon drop out of the race. Not the least important of the forces which have brought about these higher standards are the various schools of commerce and finance, including such institutions as the Alexander Hamilton In-

stitute, the correspondence schools of salesmanship and of advertising, together with some of the better class of business magazines.

Salesmanship is a science, and there is no more reason to expect a salesman to learn the principles of his profession wholly in the school of experience than there is to expect a doctor or a lawyer to do so. The principles of the science should be taught in carefully conducted schools. The practice of these principles must necessarily be largely learned by actual work. It seems probable that within a comparatively few years no progressive investment house will give a new man an opportunity as a salesman who cannot satisfactorily pass an examination in the principles of salesmanship.

The bond salesman must have a good general education. It is often asserted that bond salesmen number in their ranks more college men than any other class of salesmen. Yet men with only a high school education frequently make better salesmen than college graduates, because they often work much more efficiently and actively, and are more quick to take advantage of the opportunities presented to them for technical improvement.

The bond business demands more and more salesmen who in addition to a broad general training have had a thoro special training in financial affairs—who have a technical as well as a general education. It requires men who have a fair grounding in economics, including money, credit and banking; in accounting; in general and corporation finance; in corporate or-

ganization and management; in the principles of business administration and, above all, men with a working knowledge of the more important government, municipal, and corporation securities.

Even a superficial knowledge of the main divisions of modern science, both pure and applied, may at times be of great use to the bond salesman. The higher mathematics, physics, chemistry, geology, botany and zoology, with their broad applications to the various departments of mechanical, electrical, civil, mining and hydraulic engineering, to various manufacturing enterprises and to the principles of agriculture, may at times be of practical advantage to the bond man in enabling him to comprehend and more intelligently appreciate the relative value of the security underlying some of the bonds which he may be asked to negotiate. The high grade bond man of the future must possess a sufficiently broad education to enable him to appreciate in a general way and to his own satisfaction the many varied channels which are calling for capital. While it is not to be expected that he should on his own initiative make expert examinations of properties from various standpoints, he should have sufficient knowledge to enable him to weigh and estimate the value of the reports of the experts. Not all experts are wise counsellors from a business standpoint, and much of the capital which has been improperly applied has proven to be unprofitable because of the mistakes of the so-called experts, including self-styled financial experts.

I have roughly classed the buyers of securities into two great divisions — institutions and individuals. Which division absorbs in the aggregate the larger amount of bonds? The tendency of bond market critics has heretofore been to magnify the importance of the institutions and minimize the importance of the individuals. When it comes to the question of aggregates, it is certain that the institutions take second place to the individuals. This has been so for many years, but has been made more evident thru the great educational work in investment carried on during the Liberty Loan campaigns. Furthermore, we must not lose sight of the fact that the funds of a majority of the institutions are in the aggregate simply made up of the funds of individuals and frequently of individuals of moderate means. With this in mind it will be clear that in the final analysis the ultimate success or failure of a specific issue of bonds, or even the existence of a good or a bad general bond market, depends primarily upon the attitude of the individual investors.

France, which for many years has been one of the great creditor nations of the world, draws its vast supplies of capital from its thrifty people. There are no immense individual fortunes existing in that country. It is a nation of small savers. It is to be further noted that the individual investor in France is usually a direct investor in securities rather than an indirect investor thru the medium of savings banks

or other institutions. Securities in France must therefore be available in small denominations in order to appeal to the little capitalists, and some of the French government bonds have for years been obtainable in the low denomination of approximately the equivalent of forty cents. In this country the bond salesman of the future must see that some of his wares are in a form available for the small investor, and that at least a portion of each issue is in denominations of $100 and $500, as well as $1,000.

Staples and Specialties

In the bond business, as in the grocery business or in any other general trading business, the commodities sold may be divided into staples and specialties. In the bond business the staples are the seasoned securities of well-known corporations or municipalities, securities which have successfully passed thru the fire of panic and have not been found wanting. Many special securities have successfully passed thru panics, but unless a bond is well known in the general markets, it cannot be classed as a staple. There is always more or less of a steady demand for these securities, and the question of their sale becomes largely a question of price. Institutions are the main buyers of the staples, altho by no means the only ones. The investments of many corporate institutions are to a certain extent limited to such securities by legislative enactment.

The bond man who sells staples frequently meets with the keenest kind of competition. He may find

a dozen men calling on customers where one or two would satisfy the demand. It has been stated upon good authority that a few years ago there were 125 so-called bond salesmen visiting institutions in New York State where ten first-class salesmen could have handled the business much more efficiently. The work of these 125 men became so much of a nuisance to some of the larger institutions that they refused to see many of them. If they had seen all, it would have taken the major portion of the time of one official.

On the other hand, a specialty salesman in all lines must be a better exponent of salesmanship than the seller of staples. He must first create his demand, not cater to a demand which already exists. He must gain an audience when his proposition is an unknown or a suspicious quantity to the man he wishes to see. He must close a deal for something which at the outset the customer usually does not want. The work of the bond salesman who is selling specialties is more often among individuals and some of the smaller institutions. It is a work which is not thoroly appreciated and until recent years it has perhaps been looked down upon to a certain extent in comparison with the work of the seller of staples.

Some years ago a salesman for a New York house was reported to have disposed of $21,000,000 of bonds during the year and it was advertised as a great feat. What were the bonds? Largely bonds of one of our great railroad systems which had just been made a legal investment for the savings banks in New York State. The majority of the banks wanted the

bonds. They knew the character of the security without any explanation. They knew that they could not at that time find any other equally desirable security in which they could legally invest which would net so good a return. The house with which the salesman was connected had the goods, and the demand for them existed. His work was that of a mere order taker in comparison with the work of a specialty salesman who sells during the year in small amounts perhaps only an aggregate of $500,000, but of bond issues for which he had to create the demand. His work is of vastly higher order than that of the seller of staples.

Selling Bonds to the Small Investor

I thus emphasize the importance of the work of the specialty salesman because I have always believed that the great future development of the bond business in this country is to be among the individual investors. This is now certain in view of the educational work of the Liberty Loan campaigns. Before the first Liberty Loan was launched, it is estimated that there were only between 350,000 to 500,000 individual bond buyers in the United States. To the first Liberty Loan there were approximately 4,000,000 subscribers; to the second, 9,400,000; to the third, 17,000,000, and to the fourth over 21,000,000. If out of this vast army a minimum of 2,000,000 new investors are added to the 350,000 to 500,000 "veteran" investors existing before the United States entered the war, the potential possibilities for the growth of

the investment business are clearly apparent. As a result of the Liberty Loans, more thoro campaigns of education in some of the principles of bond investment have been carried on thruout the land than the investment bankers could themselves have accomplished in fifty years. Naturally, more salesmen will be required to meet individual investors than to deal with institutions, and consequently there will be a much larger demand for first-class individual investor salesmen than there will be for institutional salesmen.

Along with this development I anticipate a demand for a higher grade of men than are today obtainable in sufficient numbers. Unfortunately, we have our quacks in the bond business, the same as in the medical profession. We still have, altho in lessened numbers, our "one sale houses", whose main efforts are devoted to selling, sometimes thru misrepresentation, securities based upon unstable properties, but yielding the house an abnormal profit. There are some bond salesmen whose idea of the value of a bond is based principally upon the amount of profit which they receive. We have self-styled salesmen who are simply order takers, and we have men calling themselves salesmen who cannot even take orders.

The need, therefore, of a broader and higher outlook among bond salesmen is everywhere apparent. As it is true that the greatest development of the bond business is to come from work among the individual investors, so it is also true that the bond salesman of the future must be something more than

a mere salesman. He must do his part toward seeing that the capital which he gathers from the small savers is rightly and honestly applied. He must stand for publicity and still more publicity and square dealing in corporate and municipal affairs. He must insist upon the equitable treatment of capital legitimately furnished for the development of enterprises, and must refuse absolutely to secure capital for any corporation or for any community in which fair treatment of the investor is not reasonably assured. He must take perhaps the foremost part in the organization of intelligence among the investors, on the one hand to prevent the exploitation of their thrift by the unscrupulous, and on the other hand to save it from the frenzy of the demagogues.

Bond Salesmen as a Business Force

It has been said that commercial travelers are the steam and a big part of the engine, too, that makes business move; but the importance of the bond salesman in relation to the general industrial development of the country is far greater than that of the commercial traveler. It is more fundamental. The bond salesman gathers small amounts of capital into the larger reservoirs which are necessary for the conduct of modern business. Unless the bond salesman is successful, the wheels of business slow down. This was well illustrated, for instance, in the fall of 1907, when the financial barometers gave unmistakable signs of the approaching storm. Wall Street was characterized as the only blue spot in the country,

and in many sections they let it be known that they could get along very well without Wall Street; that they were absolutely independent of it.

But Wall Street is something more than a speculative arena. In the Greater Wall Street, which includes not only Wall Street and the adjacent district in New York, but State Street in Boston, Chestnut Street in Philadelphia, LaSalle Street in Chicago, and similar districts in the larger financial centers of the world,—in these districts is accumulated the capital necessary for industrial enterprise and development. They are the nerve centers, and if they are temporarily more or less paralyzed, the whole commercial organization is bound to be sooner or later affected. When you travel out over great railroads, enter perhaps into magnificent terminals at your journey's end, and see the brilliantly illuminated city at night, it may be obtaining electrical energy from the waterfall one hundred or more miles away which science has harnessed; when you see a well-developed electrical railway or a great manufacturing industry, have you ever thought of the part which the bond salesmen have played in the work? By bond salesmen I mean salesmen both large and small, the composite salesmen as exemplified by the great investment houses, as well as the individual salesmen engaged in gathering the money directly from our thrifty citizens. Under the existing economic organization, the general business of a country such as ours, with great natural resources to be developed, could not go on without the work

of efficient bond salesmen. The importance of the high character of his work should be more clearly understood, as well as the consequent necessity for first-class and specially trained men, who will insist that the capital raised thru their efforts be rightly applied and reasonably protected.

Bigger Men Needed

During the past twenty years I have had an opportunity to watch a considerable number of men in the selling forces of various bond organizations. Many have developed into most efficient salesmen; others have made lamentable failures, while still others are straggling by the wayside and doing only desultory work because they are more or less self-satisfied. If I were asked how the efficiency of a bond salesman is measured, I would answer by the degree of supervision which he requires. A man who has to be constantly watched and prompted by the sales manager, and who only half works his territory, is of little value. Among the most important qualities for a salesman to possess are concentration and initiative, but unfortunately these qualities are all too seldom found. A successful salesman must know what he is after and keep right after it. That is concentration. Initiative is doing the right thing at the right time without being told. It is perhaps the rarest quality to be found in business. Elbert Hubbard said that next to doing a thing without being told is doing it when you are told but once.

Lack of initiative in a bond salesman often can be excused if he will develop this other faculty of doing the right thing when told but once; but unfortunately many have to be told twice, and still others do the right thing only when necessity renders it essential for them to act.

The bond business is looking for men with concentration and initiative, men who, as one sales manager has stated, "can wind themselves up, set themselves going and keep themselves going, stop when it is time to stop, change direction and go at something else; men who can think up new ways of approaching, convincing and closing difficult prospects; men who can go up against a hard game and win out." The business does not need men who are continually coming back and reporting that the territory assigned to them is useless or that none of the bonds offered are adapted to the territory. Of course, the bonds may not be adapted to the territory; that is why salesmen are sent to create a demand. In a word, the business does not need order takers, but offers opportunities to active, ambitious and educated salesmen, who also are able to keep their heads from growing much too large, and their feet on the ground, while continually striving to increase the breadth of their knowledge of the business. They must realize that an efficient bond salesman is not made simply with an equipment of a few circulars descriptive of securities which he may have for sale, nor can such a salesman be developed thru a short course of study given by some investment

house. Such men, it is true, may sell a few bonds, but the business is calling for better trained men.

Upon the right foundation may gradually be built up also a knowledge of some of the more important investment security issues of more or less general character; that is, issues with which all well-equipped bond men should be familiar. Specialization must also be made in the securities which the salesman is offering from time to time, and a detailed knowledge of such securities must be had. In other words, the bond salesman must thoroly know "his goods", as is true of salesmen in any other line. A salesman cannot expect to sell bonds to a prospect until he has, theoretically speaking, sold the bonds to himself. He cannot impress a prospect with the desirability of his bonds unless he has first convinced himself of their merits. He must have faith in his securities, in his house, and in the value to the general community of his work as a security salesman. He must like the game for the game itself, in addition to looking forward to it for a livelihood and perhaps a competence. Many of the higher positions in investment security organizations have been reached thru the portal of successful salesmanship by men who, in addition to being successful salesmen, have at the same time prepared themselves for advancement to other positions requiring a high degree of executive and administrative ability.

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